S&P Global Ratings

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Research Update:

U.K.-Based Accent Group Ltd. Assigned 'A+' Rating; Outlook Negative

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Overview

- Accent Group Ltd. (Accent) is a U.K.-registered provider of social housing with operations across 68 local authority areas in the North, East, and South of England.
- In our view, Accent has a strong enterprise profile and strong financial profile. A slight deterioration in Accent's S&P Global Ratings-adjusted EBITDA margins and leverage over the next few years constrains the rating.
- We are assigning our long-term issuer credit rating of 'A+' to Accent.
- The negative outlook on Accent mirrors that on the U.K. and reflects that we could downgrade Accent if we downgrade the sovereign.

Rating Action

On July 4, 2019, S&P Global Ratings assigned its long-term issuer credit rating of 'A+' to U.K.-based social housing provider Accent Group Ltd. (Accent). The outlook is negative.

We also assigned our 'A+' issuer rating to Accent Capital PLC. Accent Capital was set up for the sole purpose of issuing bonds and lending the proceeds to Accent Housing Ltd., and we view it as a core subsidiary of the group.

Rationale

The 'A+' rating on Accent is derived from its stand-alone credit profile (SACP) of 'a'. Our assessment of Accent's SACP reflects the group's strong enterprise profile, underpinned by our view of the social housing industry as low risk and by a high proportion of Accent's revenues being derived from traditional housing activities. The SACP also reflects Accent's strong financial profile, supported by robust liquidity and modest leverage despite an ambitious development plan.

Our rating on Accent is one notch higher than its SACP of 'a'. This is because we believe that Accent benefits from a moderately high likelihood of timely and sufficient extraordinary support from the U.K. government, through the Regulator of Social Housing, in the event of financial distress. In accordance with our criteria for government-related entities, our view of a moderately high likelihood of extraordinary government support is based on our assessment of the housing provider's important role for the U.K. government and its public policy mandate, as well as its strong link with the U.K. government.

Although Accent Housing Ltd. (wholly owned subsidiary of Accent Group Ltd.) was legally formed in 2016 through the consolidation of Accent Nene Ltd., Accent Peerless Ltd., and Accent Foundation Ltd., Accent can trace its origins back to 1966. Accent now owns and manages about 20,600 homes, which are concentrated across North, East, and South England, with key locations including Bradford, Peterborough, and Surrey Heath. Accent's housing portfolio mainly comprises general needs and affordable housing--about 75% of units in fiscal year (FY) 2018--but it does have a portion of shared-ownership housing as well (5% of the portfolio). Accent's new 2019-2023 strategy will increase its proportion of shared-ownership units and total outright sales. However, the core business will remain one of low-income social housing activities, which supports our view of predictable revenue streams and low industry risk.

The economic fundamentals of Accent's main areas of operation are not very dynamic, with annual population growth averaging about 0.3%-0.4% over the next few years. That said, we assess positively the fact that social rent represents around 52% of market rent in these areas, and we expect that Accent will continue benefiting from high demand for social housing. Accent also benefits from low vacancy rates of an average of 1% over the past three years.

Accent is investing in its housing stock to improve asset quality and ensure full compliance with the Decent Homes Standard. The fact that Accent's management will focus on value-creation and the quality of the property portfolio through its proactive asset management strategy should support both demand and operating performance. For instance, Accent will be exiting its supported housing portfolio, which makes up about 2% of its total housing stock.

We view Accent's management team as skilled and experienced. We assess positively the team's clear financial strategy and refinancing of legacy debt that carries a high interest rate. In addition, management is implementing initiatives to improve operating performance and capture cost savings by disposing of less-profitable units and improving the customer experience through self-service digital facilities.

Accent's new development strategy plans for a material increase in the number of units delivered per year, equating to about 500 homes per year on average in the long term. In comparison, in FY2018, 124 new homes were completed. The development will focus on Accent's core areas of operation, which, in our view, will contribute to greater economies of scale. However, shared ownership and outright sales will play an increasingly important role in the development plan. We forecast that market sales will average 7% of total revenues between FY2019-FY2022, peaking at 14% in FY2022. While we understand that management will seek to keep sales revenue below 20% of total turnover, the higher dependence on market sales brings additional risk and volatility to the financial performance.

Our base case forecasts a slight deterioration in Accent's S&P Global Ratings-adjusted EBITDA margins to an average of 29% over the next two years. Following a weak financial year to March 2019, due to higher costs and repairs, we expect that Accent's financial performance will remain weak in FY2020 due to a number of one-off payments, including, among other things, advisory fees related to raising a new bond and investments in digital systems to improve the customer experience. In addition, improving the existing housing stock is an important feature of Accent's strategy, and we forecast that capitalized repairs will increase to an average of £14 million in FY2020-FY2023, having almost doubled in FY2019 to close to £10 million. This will also weigh on Accent's EBITDA margins throughout the next two years. If we observed a structural increase in market-related sales above 15% of total turnover, we would expect further pressure on margins and could reassess our view of financial performance. That said, in FY2021, with the ramp-up in the development plan, cost savings, and the end of rent cuts, EBITDA margins gradually increase to about 30%.

We forecast that Accent's debt to adjusted EBITDA will peak at about 16x in FY2020, compared to an average of 13x over FY2020-FY2022. Despite this apparent increase in borrowings, the debt position remains sustainable, in our view, as the sharp increase in debt results from the planned issuance of a £350 million bond in July-September, with £125 million due to be retained. Accent will use the proceeds to repay about £132 million of Nationwide Building Society debt, and the remainder will fund a portion of the development program. We anticipate that Accent's interest coverage will remain robust over the next two years, at an average of 1.9x in FY2020-FY2022.

Liquidity

We assess Accent's liquidity position as very strong. Over the next 12 months, we expect sources of liquidity to exceed planned uses by about 2.1x. With several committed undrawn facilities and the planned bond issuance, we view Accent's access to external liquidity as satisfactory. Accent should hold substantial cash holdings after the bond issuance, which would fall gradually as the development plan progresses. We view the risk to liquidity posed by Accent's existing swaps as minimal since there is no collateral associated with these derivatives.

We forecast that liquidity sources will comprise:

- Our forecast of cash generated from continuing operations of £28 million.
- Cash and liquid investments of £43 million.
- Proceeds from asset sales of £7 million.
- The undrawn, available portion of committed bank facilities or bank lines maturing beyond the next 12 months of £80 million.
- Other receipts comprising a £225 million bond.

We forecast that uses of liquidity will comprise:

- Our expectation of capital expenditure of £51 million.
- Interest and principal payments on debt of £128 million.

Outlook

The negative outlook on Accent reflects the negative outlook on the long-term rating on the U.K.

Downside scenario

We could lower the rating on Accent if we lowered the rating on the U.K. We could also lower the rating on Accent if we estimated that there was a lower likelihood of Accent receiving timely and sufficient extraordinary support from the U.K. government, through the Regulator of Social Housing, in the event of financial distress.

Upside scenario

We could revise the outlook to stable if we take the same action on the U.K. The revision of the outlook back to stable is also contingent on financial performance remaining in line with our base-case with EBITDA margins of about 30% and market-related sales below 15% of turnover.

Key Statistics

Table 1

Accent Group Ltd. Key Statistics

	--Year ended March 31--				
(Mil. £)	**2018a**	**2019a**	**2020bc**	**2021bc**	**2022bc**
Number of units owned or managed	20,633	20,623	20,808	21,091	21,403
Vacancy rates (% of net rent receivables before deducting voids losses)*	0.90	0.80	N.A.	N.A.	N.A.
Arrears (% of net rents receivable)*	4.00	4.30	N.A.	N.A.	N.A.
Revenue§	96.00	94.90	94.31	111.96	119.54
Share of revenue from non-traditional activities (%)	2.08	1.00	1.36	12.57	13.58
EBITDA†	38.00	24.40	26.04	33.40	36.40
EBITDA/revenue (%)	39.60	25.70	27.61	29.83	30.45
Interest expense	14.90	14.30	16.40	17.10	16.50
Debt/EBITDA (x)	8.70	12.90	16.18	12.04	10.91
EBITDA/interest coverage‡ (x)	2.60	1.70	1.59	1.95	2.20
Capital expense	13.10	14.70	52.70	46.40	63.50
Debt	332.06	314.60	422.06	402.06	397.06
Housing properties (according to balance sheet valuation)	589.30	683.10	N.A.	N.A.	N.A.
Loan to value of properties (%)	56.30	46.10	N.A.	N.A.	N.A.
Cash and liquid assets**	61.70	46.40	102.00	103.57	86.92

*Rent and service charge arrears net of voids. §Adjusted for grant amortization. †Adjusted for capitalized repairs. ‡Including capitalized interest. **Adjusted for cash held in constructive trust. a--Actual. bc--Base case reflects S&P Global Ratings' expectations of the most likely scenario. N.A.--Not available.

Ratings Score Snapshot

Table 2

Accent Group Ltd. Ratings Score Snapshot

Industry risk	2
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Strategy and management	3
Asset quality and operational performance	2

Table 2

Accent Group Ltd. Ratings Score Snapshot (cont.)

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S&P Global Ratings bases its ratings on non-profit social housing providers on the eight main rating factors listed in the table above. S&P Global Ratings' "Methodology For Rating Public And Nonprofit Social Housing Providers," published on Dec. 17, 2014, summarizes how the eight factors are combined to derive each social housing provider's stand-alone credit profile and issuer credit rating. For social housing providers generating more than a third of its consolidated revenues from open market sales, we also refer to the "Key Credit Factors For The Homebuilder And Real Estate Developer Industry."

Related Criteria

- General Criteria: Group Rating Methodology, July 1, 2019
- General Criteria: Rating Government-Related Entities: Methodology And Assumptions, March 25, 2015
- Criteria | Governments | General: Methodology For Rating Public And Nonprofit Social Housing Providers, Dec. 17, 2014
- General Criteria: Stand-Alone Credit Profiles: One Component Of A Rating, Oct. 1, 2010
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009

Related Research

- United Kingdom Ratings Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 26, 2019

Ratings List

New Rating	
Accent Group Ltd.	
Accent Capital PLC	
Issuer Credit Rating	A+/Negative/--